Recent developments in the ESG bonds market in Japan

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This article provides an overview of (1) basics of ESG bonds (as defined below), with specific focus on Green Bonds (as defined below); (2) new trends in Green Bond issuance by Japanese and international companies operating in the Japanese debt capital markets; (3) recent developments in the guidelines and governmental support for Green Bond issuance in the Japanese debt capital market; (4) recent reforms in the corporate governance of Japanese companies supporting the expansion of ESG bonds markets; and (5) additional procedures for ESG bond issuance in the Japanese debt capital market, focusing primarily on Green Bonds.

Introduction

ESG bonds are currently attracting considerable attention from participants in the international as well as Japanese capital markets. Following the first successful Green Bond issuance by the European Investment Bank in 2007, starting a new era of ESG bond issuances in the international capital markets, Japanese issuers and investors were reluctant to actively issue or invest in such bonds.

In 2014, the Development Bank of Japan finally issued, outside of Japan, the first Green Bonds, followed by other sovereign issuers and financial institutions. Later in 2014, the Japanese Ministry of the Environment published Japan's Green Bond Guidelines (further amended in 2017): a step that encouraged the issuance of Green Bonds by Japanese entities other than sovereign issuers and financial institutions.

Such a trend in ESG investment is paralleled by Japan's focus on reforms in corporate governance and the enactment of its corporate governance and stewardship codes. As a result, more Green Bonds, as well as Samurai Bonds, have been issued by Japanese, as well as international issuers. Finally, we will discuss supplemental procedures for the issuance of Green Bonds in the Japanese market.

Overview of ESG bonds

Initially with equity, followed by debt capital market products, such as Green Bonds, ESG investments have become increasingly popular. The trend originated from the Principles for Responsible Investment (PRI)3, announced in April 2005 by the then United Nations Secretary-General Kofi Annan, having invited a group of the world's largest institutional investors to develop PRI. The initiative was launched in April of 2006 at the New York Stock Exchange. Subsequently, Climate Awareness Bonds4, issued by the European Investment Bank, marked the opening of an era of development for ESG bonds, including Green Bonds.
While there has been no official definition, Green Bonds, Social Bonds and Sustainability Bonds are generally considered to be ESG bonds. Green Bonds are defined, among others, as "any type of bond instrument where the proceeds will be exclusively applied to finance or re-finance, in part or in full, new and/or existing eligible Green Projects" under Green Bond Principles (the "GBP") released by the International Capital Markets Association (the "ICMA"). Although the GBP is a widely recognised guideline for Green Bonds, there are others, including guidelines published by the Ministry of the Environment of Japan.

Social Bonds are defined under the Social Bond Principles released by the ICMA as "bonds that raise funds for new and existing projects with a positive social outcome"; and Sustainability Bonds are defined under the Sustainability Bond Guidelines, also issue by the ICMA, as "bonds whereby the proceeds will be exclusively applied to finance or re-finance a combination of both Green and Social Projects".

In this article, Green Bonds, Social Bonds and Sustainability Bonds are referred to, collectively, as ESG bonds.

Green Bonds have to be aligned with the four core components of the GBP: (a) use of proceeds; (b) process for project selection and evaluation; (c) management of proceeds; and (d) reporting. Pursuant to the first component, the proceeds of Green Bonds must be used for Green Projects with clear environmental benefits, which should be appropriately disclosed to the investors in the prospectus and other relevant agreements.

Under the second component, the issuer must clarify to the investors: (i) the environmental sustainability objectives of the projects; (ii) the criteria for categorising the projects within the Green Projects; and (iii) the procedure thereof. The third component requires the proceeds of Green Bonds to be properly monitored and tracked by the issuer. Lastly, according to the fourth component, the issuer is required to provide annual, up-to-date reports regarding the use of proceeds.

ESG bonds issuance trends in Japan

As described above, Climate Awareness Bonds issued by the European Investment Bank are widely considered to be the first ESG bonds in the international capital markets. Those were followed by primarily international organisations, such as the World Bank, the International Finance Corporation and the African Development Bank. In the global markets, local governments, business operating-firms and financial institutions also started issuing ESG bonds in 2010s.

As mentioned above, Japanese issuers and investors were not initially active in the ESG bonds markets. The Development Bank of Japan, one of the government-affiliated financial institutions, eventually issued the first overseas Japanese ESG bonds in September of 2014. Other Japanese financial conglomerates (so-called Megabanks), such as Mitsubishi-UFG Financial Group, Sumitomo-Mitsui Financial Group and Mizuho Financial Group etc., followed suit.

In September of 2016, the Japan International Cooperation Agency finally issued the first Japanese ESG bonds (in the narrower sense), i.e. ESG bonds issued in the Japanese market. For the first couple of years, most of the issuers were government-affiliated companies or local government, whereas various business operators, investment funds, financial institutions and other private entities entered the ESG bonds market rather abruptly at a later stage.

In the beginning of 2018, certain foreign issuers started issuing ESG Samurai bonds, i.e. ESG bonds denominated in yen, in the Japanese market. As of today, Électricité de France (EDF), Starbucks Coffee Company, BPCE, and Bank of China, Tokyo Branch, among others, issued such ESG Samurai Bonds. Japanese issuers are currently very active in the ESG bonds market and such bonds are being diversified. For example, in 2018, a Japanese issuer issued ESG euro-yen convertible bonds in the euro market.

Policy and regulations for green bonds issuance in Japan

In addition to the ICMA’s principles and guidelines for ESG bonds, there are several jurisdictions which have adopted policies in support of ESG investments, most particularly of Green Bonds. Among those, we can count the Guidelines...
issued in 2017 by the Ministry of the Environment of Japan. They were developed aiming for “raising the visibility of Green Bonds and expanding Green Bond issuance and investment within Japan in line with the global development of the Green Bond market”. Such guidelines are consistent with the GBP.

In the 2017 guidelines, Green Bonds are defined as “bonds issued by companies, local governments, or other organisations to raise funds for domestic and overseas Green Projects”. The basic concepts for Green Bonds in such guidelines are almost identical to those in the GBP. Hence, bonds which satisfy all the components specified in the guidelines are considered to have been qualified as Green Bonds under the GBP as well.

In addition, the Ministry of the Environment of Japan launched the Green Bond Issuance Promotion Platform, whereby certain professionals, such as underwriters, rating agencies, consultants etc., who are registered as those supporting the issuance of Green Bonds, are listed. The platform publicly shares current knowledge and experiences of issuing Green Bonds in Japan and overseas, highlighting trends and providing up-to-date information and analyses.

Furthermore, any such registered professionals wishing to efficiently and comprehensively support corporations or local governments with the issuance of Green Bonds may be subsidised by the Japanese Ministry of the Environment up to an amount of ¥50m. Lately, many companies have successfully issued Green Bonds using the help of professionals who were granted such subsidies.

Not only the governments, but also stock exchanges in various jurisdictions are taking steps to establish legal and administrative environments that are conducive to the issuance of Green Bonds by adopting listing regulations, etc. The Tokyo Stock Exchange launched a platform for the issuance of Green and Social bonds whereby issuers can publicly disclose certain ESG related information regarding bond listings via the Tokyo PRO-BOND Market website. Issuers may list information, such as the use of proceeds, reviews by third parties, post-issuance reporting, for instance. The Tokyo Stock Exchange uses this platform to examine whether the bonds are qualified to be listed on the Tokyo PRO-BOND Market. However, ESG related features are not taken into consideration since adherence by those is not required for such listing.

Reforms in corporate governance in Japan

During the last decade, around the same time that ESG bonds started attracting attention from Japanese issuers and investors, we also experienced various reforms in corporate governance structure and regulations in Japan.

As Japan’s Corporate Governance Code, establishing a corporate code of conduct, was launched in 2015 by the Financial Services Agency of Japan and the Tokyo Stock Exchange, ESG investments started to draw attention from shareholders of Japanese companies. For example, Principle 2.3 thereof, “Sustainability Issues, Including Social and Environmental Matters”, stipulates that “companies should take appropriate measures to address sustainability issues, including social and environmental matters”. ESG investments are apparently among the typical measures to contribute to environmental matters. On the other hand, Japan’s Stewardship Code, regulated in 2017 by the Financial Services Agency of Japan, established a code of conduct for institutional investors. Its third principle provides that, in order to fulfil their stewardship responsibilities with an...
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orientation towards sustainable growth, institutional investors should monitor companies they invest in. ESG investments are clearly instrumental in taking responsibility for the sustainable growth of companies.

In July of 2017, the Government Pension Investment Fund of Japan, the world largest pension fund, officially announced its investment principles for long-term development in enterprise value, considering ESG factors with respect to all assets, including equity and debt. It strongly encouraged Japanese companies to shift towards ESG investment.

As demonstrated above, by enhancing social responsible investments, ESG products are a useful tool for companies to advance corporate social responsibility in connection with the environment and finance. ESG investments contribute not only to pure CSR-related benefits, but also have certain financial benefits, such as diversifying financial options and improving corporate branding. Therefore, business operating-companies are recently entering the ESG bonds markets.

**Process for green bonds issuance**

As discussed in the overview, issuance of Green Bonds requires an issuer to take additional procedures pursuant to the GBP and/or other relevant guidelines. In most cases in the Japanese debt markets, the amendments to shelf registration statements or, at least, supplemental documents to the shelf registration statements of an issuer of Green Bonds must clearly describe the use of proceeds being for Green Projects with environmental benefits, in order to publicly offer the Green Bonds. Furthermore, the issuer should clarify its process of evaluation and keep monitoring and tracking the proceeds to make sure they are applied to the intended use. This is a burdensome process for the issuer whereas in other Japanese debt offerings, general corporate purposes or the like usually suffice.

In addition, most issuers of Green Bonds seek to obtain third-party reports relating to their adherence by such procedures from qualified institutions. That also requires additional resources as far as time and cost.

Following the issuance of Green Bonds and until all such bonds are redeemed, the issuer has to monitor and track the proceeds as well as provide up-to-date annual reports regarding issues, such as the actual effect on environmental improvements. Since there is no officially established platform for an issuer of Green Bonds to publicly announce such reporting to its investors, it may be a difficult procedure to follow. The platform for Green and Social bonds provided by the Tokyo Stock Exchange as mentioned above may be useful for such purposes. However, at this time there is still uncertainty as to its efficiency and whether it would suffice.

**Conclusion**

As illustrated above, an issuer of ESG bonds, including Green Bonds, would be able to achieve certain benefits and obtain better conditions than issuers of ordinary bonds, based on the current trends in the ESG bonds market as illustrated above. It would also establish its brand awareness as an ESG company by being part of current trends of corporate governance and responsible investment principles. On the other hand, ESG bonds are costly options. There are additional expenses associated with reaching and maintaining the status of qualified ESG bonds. Therefore, we expect ESG bonds to attract more and more attention, but at the same time, there is a need to conduct a comprehensive cost/benefit analysis of such issuances from various standpoints, including economical and CSR-related perspectives.

**Notes:**

1. ESG generally stands for Environmental, Social and Governance.
2. For more details, please see at https://www.unpri.org/pri/about-the-pri
3. For more details, please see at https://www.eib.org/en/investor_relations/cab/index.htm
4. The Green Bond Principles were initially announced in 2014, subsequently revised and most recently updated as of June 2018 by the ICMA. Please see at https://www.icmagroup.org/green-social-and-sustainability-bonds/green-bond-principles-gbp/
5. For the outline in English, please see at https://www.env.go.jp/policy/greenbond/gb/gl_point_en.pdf
6. The Social Bond Principles were initially announced in 2017 and most recently updated as of June 2018 by the ICMA. Please see at https://www.icmagroup.org/green-social-and-sustainability-bonds/social-bond-principles-sbp/
7. The Sustainability Bond Guidelines were initially announced in 2017 and most recently updated as of June 2018 by the ICMA. Please see at https://www.icmagroup.org/green-social-and-sustainability-bonds/sustainability-bond-guidelines-sbg/
8 For more details, please see supra note at https://www.icmagroup.org/green-social-and-sustainability-bonds/green-bond-principles-gbp/
9 For the outline in English, please see at https://www.env.go.jp/policy/greenbond/gb/gl_point_en.pdf
10 For more details, please see at http://greenbondplatform.env.go.jp/en/
11 For the outline in English, please see at https://www.jpx.co.jp/english/equities/products/tpbm/green-and-social-bonds/index.html
12 For the English translations, please see at https://www.jpx.co.jp/english/news/1020/b5b4q000000qvx-att/20180602_en.pdf
13 For the English translations, please see at https://www.fsa.go.jp/en/refer/councils/stewardship/20170529.html

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